



Treasury Inspector General for Tax Administration

MANAGEMENT HAS EMPHASIZED THE FRAUD PROGRAM, BUT OPPORTUNITIES EXIST TO FURTHER IMPROVE IT

Issued on September 18, 2007

Highlights

Highlights of Report Number: 2007-30-179 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

IMPACT ON TAXPAYERS

Internal Revenue Service (IRS) procedures require that identification and development of potential criminal fraud and civil fraud penalty cases be considered during all examinations conducted by the Examination function. When initial indicators of fraud are identified, the examiner should consult with his or her group manager and then contact a fraud technical advisor (advisor) as soon as possible for technical guidance and advice. Fraud indicators consist of one or more acts of intentional wrongdoing on the part of the taxpayer with the specific purpose of evading tax. Although examiners are generally identifying cases with potential indicators of fraud, the case documentation indicated they did not fully develop fraud issues or did not contact an advisor, when appropriate, in some cases. Criminal prosecution and civil fraud penalty assessment serve as deterrents to noncompliance and foster voluntary tax compliance.

WHY TIGTA DID THE AUDIT

This audit was initiated to determine whether Examination function employees are identifying potential fraud cases and referring cases to the Criminal Investigation function when appropriate and to evaluate the effectiveness of the advisor position. This audit was conducted as part of the annual audit plan.

WHAT TIGTA FOUND

Examiners are documenting when they consider fraud during an examination and generally are identifying fraud indicators. However, in 11 (14 percent) of the 77 cases reviewed, examiners did not adequately identify fraud indicators, fully develop fraud issues, or contact an advisor when appropriate.

In addition, in 15 (26 percent) of 58 cases, the examiners did not timely discuss the substantial understatement of income with their group managers, as required.

As a result of not properly identifying or fully developing potential fraud issues on six cases, the IRS may not deter noncompliance and could fail to collect revenue because penalties were not assessed. In addition, if the IRS does not address tax fraud among those who generally do not comply, voluntary tax compliance may decrease among those taxpayers who generally do comply.

Our review of 30 Examination function cases being developed for fraud issues and referred to advisors showed advisors were sufficiently involved but maintained inconsistent documentation for the cases.

Fraud referral and civil fraud penalty statistics indicate that, overall, the Fraud Referral Program has helped to increase the number of referrals and civil fraud penalties assessed since Fiscal Year 2001, when the advisor groups were established. In the Examination function, the acceptance rate has increased. However, the number of Examination function referrals sent to and accepted by the Criminal Investigation function has increased only somewhat since Fiscal Year 2001 and had some upward and downward trends during that time.

WHAT TIGTA RECOMMENDED

TIGTA recommended the Director, Examination, and Director, Fraud/Bank Secrecy Act, reinforce the requirements to timely contact an advisor when *initial* indicators of fraud exist, properly complete the Fraud Development Status (Form 11661) as required and whenever the advisor participates in a significant discussion during the examination, require examiners to update Form 11661 by contacting the advisor prior to closing the case, and emphasize the requirement for examiners to timely discuss with the group manager those cases with substantial amounts of unreported income. In addition, the Director, Fraud/Bank Secrecy Act, should establish a formal documentation process that tracks advisor involvement in cases, including requirements to maintain adequate and consistent records.

In their response to the report, IRS officials agreed with the recommendations and have taken or plan to take adequate corrective actions.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2007reports/200730179fr.pdf>.